

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GEORGE E. BAILEY	:	DETERMINATION
	:	DTA NO. 806321
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Year 1976.	:	

Petitioner George E. Bailey, 1016 Glenwood Boulevard, Schenectady, New York 12308 filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the year 1976.

A hearing was held before Catherine M. Bennett, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York on October 17, 1991 at 9:15 A.M., with all briefs to be submitted by April 24, 1992. Petitioner, who appeared pro se, submitted a supplemental affidavit on January 31, 1992. The Division of Taxation, appearing by William F. Collins, Esq. (Arnold M. Glass, Esq., of counsel), gave notice that it would not submit a brief on May 7, 1992.

ISSUES

I. Whether petitioner is subject to a penalty imposed pursuant to Tax Law § 685(g) as a person who willfully failed to collect, truthfully account for and pay over withholding taxes due.

II. If so, whether petitioner is liable for the entire penalty or whether the Division of Taxation should attempt to collect a proportionate share thereof from the other corporate officer and shareholder.

III. Whether Article 3-A of the Lien Law precludes the Division of Taxation from proceeding against petitioner.

FINDINGS OF FACT

Bailey Construction Company, Inc. ("Bailey Construction"), incorporated in 1969, is a

construction company operating primarily as a general contractor performing public improvement contracts for governmental entities. Petitioner, George E. Bailey, president of the corporation, and his wife, Constance Bailey, secretary-treasurer, were sole owners of Bailey Construction, each holding a 50 percent share of the corporation's stock. Petitioner drew a salary from Bailey Construction and was responsible for designing and bidding projects, and providing oversight for purchasing and project completion. Petitioner hired most of the employees with the exception of tradesmen, who were typically hired by the foreman or field superintendent of a particular project. All of the financial aspects of the corporation such as banking and payroll were controlled by petitioner and his wife. Additionally, both had check-signing authority. Petitioner signed payroll checks and tax returns. It was also petitioner's decision not to remit the withholding taxes at issue, and he admitted the taxes have remained unsatisfied.

During the hearing when petitioner was asked by the Administrative Law Judge whether he would concede that "without any argument, that pursuant to the New York State Tax Law that [he] would fall under the category of an officer who is responsible for the management and general operations of the corporation?", he responded in the affirmative.

Bailey Construction, on January 6, 1977, submitted Forms IT-2101, Employer's Return - Personal Income Tax Withheld, to the New York State Income Tax Bureau for the following periods:

10/16/76 - 10/31/76
11/1/76 - 11/15/76
11/16/76 - 11/30/76
12/1/76 - 12/15/76
12/16/76 - 12/31/76

The Division of Taxation ("Division") was referred to Peerless Insurance Company ("Peerless") for payment. Payment bonds were in effect for the projects performed which resulted in withholding taxes due. Petitioner asserts all monies owed for labor expended were payable under the bonds. The projects under construction were public projects performed for New York State as follows:

Gore Mountain Ski Center
Phase I - Pumphouse
North Creek, New York
General Construction Contract (a) Bond #P663762

Coxsackie Correctional Facility
Construction Work for Alterations and Improvements at
Laundry Building #52
Bond #P667892

The Division contacted Peerless but was unsuccessful in collecting payment. Petitioner believed this was because the statute of limitations period of one year on payment bonds ran before the State sought collection. In a letter dated August 4, 1978, the Division notified Bailey Construction that since Peerless did not satisfy the claim for withholding taxes due, Bailey Construction would be "totally liable for any and all tax liabilities."

A warrant was issued by the State Tax Commission against Bailey Construction, on November 20, 1980 and filed by the County Clerk's Office in Schenectady, New York on November 21, 1980 for the periods of October 16, 1976 through October 31, 1976, November 1, 1976 through November 15, 1976, and December 1, 1976 through December 15, 1976. The warrant referenced assessment numbers W7703296294, W7708012820 and W7703296297 for taxes in the total amount of \$1,313.10, plus penalty and interest in the amount of \$985.49.

On September 30, 1982, the Tax Compliance Division corresponded with petitioner and his wife informing them that both Mr. and Mrs. Bailey "[a]s individual officers, . . . are liable for paying withholding tax."

Levies were served by the Division at Schenectady Trust and Pioneer Savings Bank on August 4, 1988¹ in an attempt to satisfy the outstanding warrant. Both banks responded separately by letters dated August 8, 1988, stating their records did not show any accounts under the name Bailey Construction, and they were, therefore, unable to remit payment.

¹Included in Exhibit "G" is a Tax Compliance Division contact sheet, which indicated that levies were served at Mohawk National, 1st National and Key Bank as well, but only copies of levies and responses to levies from Schenectady Trust and Pioneer Savings Bank were submitted into evidence.

On December 11, 1987, the Division issued a Notice of Deficiency to petitioner for a penalty in the amount of \$1,313.10 for willful failure to pay over withholding taxes due. A conciliation conference was conducted on July 26, 1988 and on August 19, 1988, a Conciliation Order was issued sustaining the notice. On November 21, 1988 and January 8, 1991, respectively, petitioner filed a petition and an amended petition for redetermination of the deficiency. In his petition, petitioner alleged:

- The Division failed to show the tax alleged due has not been paid nor has the Division established a ground for the imposition of any penalty.
- Since there are two officers of Bailey Construction Company, Constance Bailey, the other officer, should be ordered to appear in this proceeding as a party to share petitioner's liability.
- The liability at issue arose from the performance of a public contract; therefore, Article 3-A of the Lien Law operates in this instance instead of the Tax Law, thereby making the Notice of Deficiency unenforceable.

In this instance, the labor expenses and withholding tax liability arose from public improvement contracts between Bailey Construction and New York State. Petitioner explained that under Article 3-A of the Lien Law, monies owed to Bailey Construction for performing the project were paid directly by the governmental entity into a separate trust fund created especially for each project in order to finance that particular project. Bailey Construction did not receive money directly from the government. The purpose of Article 3-A is to prevent funds for one project from being used in financing another project, thereby preventing improper beneficiaries from collecting monies owed. The beneficiaries are the various creditors of the project, one of which was New York State Department of Taxation and Finance. Bailey Construction served as trustee to the trust ensuring proper distribution to the beneficiaries. Therefore, even though the contract was performed by Bailey Construction and its employees, petitioner contends that due to provisions in the Lien Law, the withholding tax would be improperly paid if its source was other than the trust fund established for the project. Petitioner maintains he is protected by the Lien Law and therefore cannot be held liable for taxes which must be paid from the trust.

Another complication arose from the performance of this project when New York State failed to pay money into the trust for distribution to the beneficiaries. Bailey Construction, as trustee, brought an action in the Court of Claims against New York State for recovery of funds owed to the trust. By order dated December 13, 1983, the court determined that the State of New York owed damages in the amount of \$43,000.00. However, petitioner contends that the \$43,000.00 less legal expenses of \$8,600.00 was not received by the trustee, but was diverted by an order of the Supreme Court of the State of New York, County of Schenectady, on November 8, 1984, and paid out to other improper beneficiaries. Therefore, pursuant to section 77 of the Lien Law, the Division's only recourse is to bring an action, along with Bailey Construction, as trustee, to enforce the trust in order to recover any outstanding taxes.

Conversely, the Division maintains that the corporation is liable for withholding tax arising from compensation paid to employees of Bailey Construction. Since satisfaction of the tax could not be obtained from the corporation, the notice was properly issued against petitioner, as a responsible officer of Bailey Construction under Tax Law § 685(g).

CONCLUSIONS OF LAW

A. Tax Law § 685(g) provides, in pertinent part:

"Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

Tax Law § 685(n) defines persons subject to the section 685(g) penalty as follows:

"[T]he term person includes an individual, corporation or partnership or an officer or employee of any corporation . . . who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs."

The question of whether an individual is a person within the meaning of section 685(n) is a factual one (see, Matter of Ragonesi v. New York State Tax Commn., 88 AD2d 707, 451 NYS2d 301), "resolution of which turns on such factors as whether the taxpayer owned stock, signed the tax returns, exercised authority over employees and assets of the corporation, derived substantial income from the corporation, or served as an officer or employee thereof" (Matter of

Capoccia v. New York State Tax Commn., 105 AD2d 528, 481 NYS2d 476, 477).

It is obvious from the record in this case that according to the factors mentioned above, petitioner is a person required to collect, truthfully account for and pay over withholding taxes. He is president and half owner of the corporation, holding 50 percent of the stock of Bailey Construction. He has control over essentially every aspect of the corporate operations, from the day-to-day functions to long-term planning, bidding and designing projects. He hires employees, signs paychecks and tax returns, handles all the banking and financial aspects of the corporation and is paid a salary. Accordingly, it must be found that petitioner is a person required to collect and pay over the tax. However, in order to sustain the imposition of penalty it must be found that petitioner's actions in this regard were willful.

B. "Willfulness" has been interpreted as meaning an "act, default, or conduct, consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over No showing of intent to deprive the Government of its money is necessary but only something more than accidental nonpayment is required [citations omitted]" (Matter of Levin v. Gallman, 42 NY2d 32, 396 NYS2d 623, 624-25). The court in Wolfstitch v. New York State Tax Commn. (106 AD2d 745, 483 NYS2d 779) determined that the willfulness standard was met when petitioner, a responsible officer under the statute, admitted filing returns without payment. Similarly, in this case, the corporation submitted withholding tax returns without including payment and petitioner admitted it was his decision, which he had authority to make, not to remit the tax. Sufficient evidence exists to conclude petitioner willfully failed to pay the tax within the meaning of Tax Law § 685(g) in that he knowingly and voluntarily disregarded his obligation under the statute.

C. The penalty imposed by Tax Law § 685(g) creates joint and several liability (Hartman v. United States, 538 F2d 1336, 1340 [8th Cir 1976]).² "[A] taxpayer who is equally liable with

²It should be noted that Tax Law § 685(g) is modeled after section 6672 of the Internal Revenue Code and, as a result, Federal cases may be used for guidance (Yellin v. New York State Tax Commn., 81 AD2d 196, 440 NYS2d 382).

another for the payment of accrued but unpaid tax, cannot avoid collection against himself on the ground that the Government should first collect it from another party [citations omitted]" (Kelly v. Lethert, 362 F2d 629, 635 [8th Cir 1966]). Therefore, petitioner may not use as a defense to the penalty that the Division failed to proceed against another officer, Constance Bailey, who may be equally liable.

D. Petitioner asserts that the Division should be required to proceed as a beneficiary of a statutory trust pursuant to Article 3-A of the Lien Law for payment of the withholding tax deficiency sought against him as a responsible officer.

Lien Law § 70(1) provides, in pertinent part:

"The funds described in this section received . . . by a contractor under or in connection with a contract for an improvement of real property, or home improvement, or a contract for a public improvement in this state, or received by a subcontractor under or in connection with a subcontract made with the contractor for such improvement of real property . . . or public improvement . . . shall constitute assets of a trust for the purposes provided in section seventy-one of this chapter."

Lien Law § 71(2) states, in part:

"The trust assets of which a contractor or subcontractor is trustee shall be held and applied for the following expenditures arising out of the improvement of real property . . . or public improvement and incurred in the performance of his contract or subcontract, as the case may be:

"(a) payment of claims of subcontractors, architects, engineers, surveyors, laborers and materialmen;

"(b) payment of the amount of taxes based on payrolls including such persons and withheld or required to be withheld and taxes based on the purchase price or value of materials or equipment required to be installed or furnished in connection with the performance of the improvement;

"(c) payment of taxes and unemployment insurance and other contributions due by reason of the employment out of which such claims arose . . ." (emphasis added).

In an attempt to explain his position, petitioner submitted a decision by the State Supreme Court that set forth a determination of the priorities of claims of certain parties including First National Bank of Scotia, New York State Department of Labor, Internal Revenue Service and Peerless Insurance Company (First National Bank of Scotia v. Bailey Construction Co., Sup Ct,

Schenectady County, November 8, 1984, Mercure, J.). Bailey Construction entered into public improvement contracts with the New York State Department of Environmental Conservation ("Encon"). Peerless was responsible for the insurance of statutory performance and labor and material payment bonds on each of the two contracts that Bailey Construction had entered into with Encon. The State alleged default by Bailey Construction and terminated the contracts. Thereafter, Peerless paid on claims from various contractors, suppliers and materialmen in connection with the bonded project and in the above-referenced case sought priority status to the extent it was subrogated to the rights of its payees under Article 3-A of the Lien Law. Bailey Construction, in a prior case, sued the State for damages resulting in a net recovery of \$34,400.00 after legal expenses. The First National decision decided the fate of this recovery. The bank's claim against the recovery is based on a judgment obtained against Bailey Construction, George Bailey and Constance Bailey. The State's claim is based on Bailey Construction's purported liability for unemployment insurance benefits attributable to the State projects, and the Internal Revenue Service asserts its claim based on liability of the construction company for income and FICA taxes withheld from and FICA taxes attributable to wages paid to its employees for the periods ending September 30, 1976 and December 31, 1976. The court determined that the judgment obtained by Bailey Construction is governed by Article 3-A of the Lien Law which provides for the enforcement of statutory trusts for the benefit of subcontractors, laborers, materialmen, taxing authorities and other beneficiaries designated therein. It concluded that the State and the Internal Revenue Service are Article 3-A beneficiaries to the extent of taxes directly attributable to the State projects as would qualify under Lien Law § 71. The court made an award of the funds in accordance with the priorities established under Lien Law § 77, which in this case satisfied the State's unemployment insurance claims, a portion of the Internal Revenue Service claim and a portion, if not all, of the Peerless payments.

Petitioner takes the position that, initially, Encon wrongfully retained the funds that Bailey Construction needed to make the State withholding tax payments. Petitioner claims that

later, the funds finally paid into the trust were diverted by the Supreme Court order in First National (supra). Petitioner argues that this sequence of events gives him reason not to have paid such taxes. His contention is without merit.

The First National case does not indicate that New York State was basing its claim in that matter on State withholding taxes that were unpaid by Bailey Construction. Thus, for petitioner to assert that the court diverted funds improperly is without substance. Even if the State's claim was for the withholding taxes, the Lien Law provides guidance to the contractor alone as to the distribution of funds. The contractor here was Bailey Construction, not petitioner George Bailey. Without passing judgment on whether the State could have or should have asserted a claim against trust assets pursuant to Article 3-A of the Lien Law, those provisions did not insulate George Bailey from liability as an officer. It has been well established that:

"Federal courts consider the penalty imposed upon individuals for willful failure to pay withholding taxes to be neither derivative of nor secondary to the corporate employer's liability for the same tax. The personal liability imposed by section 6672 of the Internal Revenue Code is 'separate and distinct' from that imposed on the corporate employer and is not dependent on the rules which govern the employer's liability. Similarly, we are of the view that the penalty assessed against petitioner in the instant case is separate and independent of the corporate liability for the unpaid withholding taxes [citations omitted]" (Matter of Yellin v. New York State Tax Commn., 81 AD2d 196, 440 NYS2d 382, 384).

E. Bailey Construction was obligated to withhold employee income taxes and petitioner was at least one of the corporate officers responsible for such deductions. Any money actually deducted was required to be held as a "special fund in trust for the tax commission" (Tax Law § 675; see, Matter of Levin v. Gallman, 42 NY2d 32, 396 NYS2d 623, 625). Petitioner never met this obligation and as such the penalty must stand.

F. The petition of George E. Bailey is denied and the Notice of Deficiency dated December 11, 1987 is sustained in its entirety.

DATED: Troy, New York
January 7, 1993

/s/ Catherine M. Bennett
ADMINISTRATIVE LAW JUDGE